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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

NORINE J. AUGUS, ADMX., GEORGE DOHERTY, RAYMOND NICHOLAS, ADRIAN PARKER, HUGH J. McKOWNE, MARGARET M. McAULIFFE, ADMX., JOHN FEDOR, MAURICE DUNLAP, JOSEPH COYLE, CATHERINE CURRISTAN, ADMX., JOSEPH MULLER, ROBERT J. JERRY AND JOHN J. WALSH,

Petitioners,

against

HERMAN T. STICHMAN, TRUSTEE OF HUDSON & MANHATTAN RAILROAD COMPANY, DEBTOR, ET AL.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT, TRUSTEE OF THE DEBTOR, IN OPPOSITION

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INDEX

	PAGE
QUESTION PRESENTED	1
STATUTE INVOLVED	1
STATEMENT	2
ARGUMENT	4
CONCLUSION	13

CITATIONS

CASES

Bowen v. *Hockley*, 71 F. 2d 781 (4th Cir. 1934)	8, 9, 10
Brooks v. *St. Louis-San Francisco Ry.*, 180 F. 2d 185 (8th Cir. 1950), *cert. denied*, 339 U. S. 966 (1950)	8, 9
Case v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 (1939)	5
In re Hudson & Manhattan R. R., 229 F. 2d 616 (2d Cir. 1956), *cert. denied*, 351 U. S. 982 (1956)	2
In re Hudson & Manhattan R. R., 138 F. Supp. 195 (S. D. N. Y. 1955)	2
In re Hudson & Manhattan R. R., 126 F. Supp. 359 (S. D. N. Y. 1954)	3
Johnson Fare Box Company v. *Doyle*, 250 F. 2d 656 (2d Cir. 1958), *cert. denied*, 357 U. S. 938 (1958)	7
Marine Harbor Properties, Inc. v. *Manufacturers Trust Co.*, 317 U. S. 78 (1942)	5
Nathanson v. *National Labor Relations Board*, 344 U. S. 25 (1952)	12

PAGE

In re New York, N. H. & H. R. R., 92 F. 2d 428 (2d Cir. 1937), *cert. denied*, 303 U. S. 650 (1938) 8, 10
Northern Pacific Ry. v. *Boyd*, 228 U. S. 482 (1913) 5
Pennsylvania Steel Co. v. *New York City Ry.*, 216 Fed. 458 (2d Cir. 1914) 6
Pitcairn v. *Fisher*, 78 F. 2d 649 (8th Cir. 1935) 7, 8, 9
Reconstruction Finance Corporation v. *Missouri-Kansas-Texas R. R.*, 122 F. 2d 326 (8th Cir. 1941) 8, 9
St. Louis Trust Co. v. *Riley*, 70 Fed. 32 (8th Cir. 1895) 6
Veatch v. *American Loan & Trust Co.*, 79 Fed. 471 (8th Cir. 1897), *aff'd on rehearing*, 84 Fed. 274 (8th Cir. 1897) 6

STATUTES

Bankruptcy Act
Section 77, 11 U. S. C. §205 ..... 3, 4
Section 77(n), 11 U. S. C. §205(n) 3, 4
Section 197, 11 U. S. C. §597 1
Federal Employers' Liability Act (45 U. S. C. §51 *et seq.*) 2, 11, 12

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BRIEF FOR RESPONDENT, TRUSTEE OF THE DEBTOR, IN OPPOSITION

Question Presented

In a proceeding under Chapter X of the Bankruptcy Act, must pre-administration employee tort claimants be accorded priority over secured bondholders and other unsecured creditors, including other tort claimants?

Statute Involved

The only statute involved is Section 197 of Chapter X of the Bankruptcy Act (11 U. S. C. §597). The pertinent provisions of Section 197 are as follows:

"For the purposes of the plan and its acceptance, the judge shall fix the division of creditors and stockholders into classes according to the nature of their respective claims and stock.* * *"

Statement

Hudson & Manhattan Railroad Company ("the Debtor") owns and operates an interurban electric passenger railroad, two large office buildings, and other real estate. On August 11, 1954, an involuntary petition under Chapter X of the Bankruptcy Act was filed against it. A receiver was appointed on November 24, 1954. Subsequently, the Chapter X petition was approved and the Trustee was appointed. See *In re Hudson & Manhattan R. R.*, 229 F. 2d 616, 618 (2d Cir. 1956), *cert. denied*, 351 U. S. 982 (1956); *In re Hudson & Manhattan R. R.*, 138 F. Supp. 195 (S. D. N. Y. 1955).

The petitioners herein are 13 employees or personal representatives of deceased employees of the Debtor. There are, however, a total of 91 claims on file in the proceeding for torts antedating the appointment of the receiver. Of these, 33 were filed by employees or their representatives ("employee claims"), and 58 by others, such as passengers allegedly injured while using the Debtor's facilities ("public claims"). All of the employee claims arose under the Federal Employers' Liability Act ("FELA") (45 U. S. C. §51 *et seq.*).*

The Debtor's plan of reorganization, which has been approved by the District Court, establishes a number of

* All claims arising after the appointment of the receiver, whether FELA claims or otherwise, are paid in full as expenses of administration.

classes of creditors. Unsecured creditors are divided into several classes. Those who hold six-months' claims or other claims entitled to priority are in classes which will be paid in cash the amounts of their claims as finally allowed. All other unsecured creditors are to be paid 10 cents in cash for each dollar of their claims as finally allowed. The three classes of the Debtor's bondholders, with claims totaling over $60 million, will not be paid in full under the plan, but will receive securities of the reorganized company.

The resolution of the priority question raised herein will thus determine whether petitioners will receive 10 or 100 cents per dollar on their allowed claims. There is no issue as to the fairness of the respective treatments of bondholders and unsecured creditors under the plan.

In the District Court, the status of both employee and public claims was in issue. Priority was denied to all these claims on the basis of the well-established federal equity receivership precedents that pre-receivership tort claims are not entitled to preferred treatment (2a).*

As to the employee claims, the District Court recognized that there was a limited statutory exception to the general equity rule. However, it pointed out that this exception, contained in Section 77(n) of the Bankruptcy Act, only grants priority to employees of a "railroad corporation" as defined by Section 77 [11 U. S. C. §205(n)]. Since the Debtor had been held not to be a "railroad corporation" subject to Section 77 [*In re Hudson & Manhattan R. R.*, 126 F. Supp. 359 (S. D. N. Y. 1954)], the District Court concluded that the exception did not apply in this case. It therefore followed the general equity rule.

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* References to pages followed by "a" are to the appendix to the petition herein. References to pages preceded by "R." are to the stenographic minutes of the hearing in the District Court, part of the record on appeal.

No appeal was taken from the denial of priority to the public claims. Petitioners appealed, contending that equity requires that a priority be granted to their claims even though there is no statutory or judicially-recognized basis therefor.

The Court of Appeals for the Second Circuit unanimously affirmed the judgment of the District Court. It pointed out that, prior to 1933, equity receivership courts uniformly held that pre-receivership employee tort claims "were not equitably entitled to a preference over secured creditors" (8a). It further pointed out that, since the statutory exception to this rule contained in Section 77 (enacted in 1933 and amended in 1939) had not been extended by Congress to employees of railroads reorganizing under Chapter X, it would be judicial legislation to grant the requested priority (9a).

Petitioners concede that the District Court and the Court of Appeals were correct in their rulings that Section 77(n) of the Bankruptcy Act is inapplicable to this case (Petition, p. 10). Despite this concession, petitioners contend that, because they are railroad employees and their claims arose under the FELA, the equity precedents should have been disregarded and a new priority created for them by judicial invention.

Argument

1. The decision below does not involve an important issue of federal law that would warrant review by this Court. While petitioners have attempted to present a more limited question, the real issue is whether pre-administration employee tort claims in any Chapter X proceeding are entitled to priority status. Indeed, one might even view the question as relating to all pre-administration tort claims

because it is most difficult to differentiate between employee and public claims in this respect.

However viewed, the question involved herein has been answered conclusively by a long line of decisions in equity receiverships and Chapter X proceedings. The requirement that a Chapter X plan be fair and equitable embodies the "absolute priority rule" established in *Northern Pacific Ry.* v. *Boyd*, 228 U. S. 482 (1913). See *Marine Harbor Properties, Inc.* v. *Manufacturers Trust Co.*, 317 U. S. 78 (1942); *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 (1939). The principle of the *Boyd* case is that senior creditors must receive the full value of their claims in a reorganization before junior creditors or stockholders receive anything.

To be excepted from this fundamental principle, there must be a statutory or judicially-recognized basis for according an unsecured creditor priority over bondholders. There is no such basis here. On the contrary, the well-settled equity rule that pre-receivership tort claims are not entitled to priority clearly forecloses the granting of priority status to the petitioners.

Chapter X proceedings have been conducted effectively for over 20 years in accordance with this rule. There thus is no need in connection with the administration of the Bankruptcy Act for this Court to consider the question presented herein. This is particularly true if the question is viewed as the more limited issue framed by petitioners—the priority status of pre-administration FELA claims in a Chapter X proceeding. Since petitioners would have this Court establish a more favorable rule for FELA claims than would be applicable to other types of employee tort claims, it is obvious that the issue they raise would not be involved in most Chapter X proceedings.

2. Petitioners also contend, as a basis for granting the writ, that "The decision below represents the refusal of a chancellor to do that kind of equity which is demanded by the facts at bar" (Petition, p. 7). This assertion, addressed to the correctness of the exercise of discretion by the courts below, does not provide a sufficient basis for this Court's consideration of this case. In any event, the assertion cannot be substantiated because, we submit, the courts applied equitable principles and applied them correctly.

The District Court obviously looked to the clearly-developed body of relevant decisions in equity receiverships, Judge Dawson cited three cases—*St. Louis Trust Co.* v. *Riley*, 70 Fed. 32 (8th Cir. 1895); *Pennsylvania Steel Co.* v. *New York City Ry.*, 216 Fed. 458 (2d Cir. 1914); and *Veatch* v. *American Loan & Trust Co.*, 79 Fed. 471 (8th Cir. 1897), *aff'd on rehearing*, 84 Fed. 274 (8th Cir. 1897)—in support of his conclusion that "It is well established that all tort claims against a Debtor which has gone into receivership are to be denied priority if the claim ante-dated the receivership" (2a). Each of these cases was decided by a court in an equity receivership. Similarly, the Court of Appeals referred to and relied upon the equity receivership precedents (8a).

What petitioners really mean, we suspect, is that the courts below refused to equate "sympathy" with "equity". Thus, in colloquy with counsel in the District Court, Judge Dawson stated (R. 8747-8):

> "The Court: Well, I don't believe an argument is in equity based purely on sympathy. I don't believe that the law can be applied on the basis of sympathy. I do think that equity means with due regard to the provisions of law that have been laid down. Anybody who gets up and argues on the sympathetic basis I am going to say is wasting

> their time because you have sympathy in a lot of cases but if they argue on the straight legal question of equity I would be glad to hear it."

It is true that there are limited exceptions to the absolute priority rule first developed in equity receiverships. One such exception, the "six-months' rule", accords priority to certain types of unsecured pre-receivership claims. In *Johnson Fare Box Company* v. *Doyle*, 250 F. 2d 656 (2d Cir. 1958), *cert. denied*, 357 U. S. 938 (1958), this rule was characterized as follows (at 657):

> "The so-called six months' priority rule is an invasion of the established contract rights of lienholders. As an invasion the rule should be strictly contained within narrow confines and limited to the purposes which brought it into being. In summary, the rule assumes that debts contracted during a short period, usually fixed at six months before a receivership, for labor, supplies or repairs necessary for a company's operation so redound to the benefit of the lienholders and other creditors that they should receive preferred treatment. On the other hand, new equipment purchased and new construction as distinguished from repairs would not fall within the preferred class. * * *"

In recognition of the limited scope of this deviation from the "absolute priority rule", the courts have uniformly refused to grant priority to tort claims through the six months' rule. In *Pitcairn* v. *Fisher*, 78 F. 2d 649 (8th Cir. 1935), an equity receivership of a railroad, it was contended that an employee tort claim should be preferred because it arose less than six months prior to the receivership. The lower court granted the priority, but the Court of Appeals for the Eighth Circuit reversed, stating in part (at 652):

> "So, it is too plain for argument, that an alleged preference for claims for damages for personal injuries, is bottomed on no better basis than sentiment, and such a consideration is not for the courts, when in the teeth of the existing law; but such things are for the Congress, which has power to make new laws or to change old laws. The court cannot change the law; it can only interpret it and announce it, or apply it to facts as the facts exist. So. too, it is clear, that there is no better reason in law for making a claim of an employee a preferred claim when it arises from a judgment for damages for negligence than there is for making the similar claim of a passenger preferred under the same circumstances. For in neither case does the accrual of the claim add one jot or tittle to the preservation of the property, or toward an increase of its value. In fact, it is in derogation instead of augmentation of value; it lessens it, instead of increasing it."

The refusal to grant priority has extended to tort claims of employees and others, both within and earlier than the six-months' period. In addition to the *Pitcairn* case and the decisions cited at page 6, see *Brooks* v. *St. Louis-San Francisco Ry.*, 180 F. 2d 185 (8th Cir. 1950), cert. *denied*, 339 U. S. 966 (1950); *In re New York, N. H. & H. R. R.*, 92 F. 2d 428 (2d Cir. 1937), *cert. denied*, 303 U. S. 650 (1938).

3. Petitioners do not assert that the decision below is in conflict with any decision of another court of appeals or of this Court. In an effort to come within this Court's requirements for review, they refer to two cases which allegedly conflict "in genuine principle" with the decision of the court below (Petition, p. 7). These cases are: *Reconstruction Finance Corporation* v. *Missouri-Kansas-Texas R. R.*, 122 F. 2d 326 (8th Cir. 1941), and *Bowen* v. *Hockley*,

71 F. 2d 781 (4th Cir. 1934). There is no conflict between these decisions and the decision below in actuality or in "principle".

(a) The *RFC* case involved a federal equity receivership of a railroad corporation. During the receivership, a railroad employee was injured in the course of his employment. Since the injury occurred during the receivership, there was no question that the employee's claim was an administration expense entitled to priority. The problem presented arose from the inadequacy of the assets of the estate to provide for the payment in full of all expenses of administration.

Under these circumstances, the district court felt constrained to rank the claims of administration creditors among themselves. It gave top priority to judicial costs, second priority to federal taxes, third priority to state and local taxes, fourth priority to the receiver's operating expenses (including the employee's tort claim), and fifth priority to certain RFC certificates. It was apparent that creditors in the fourth category would not be paid in full. On appeal, the Court of Appeals for the Eighth Circuit ruled that the employee's tort claim should be accorded a priority over other expenses included in the fourth priority group.

The *RFC* case thus did not involve a question of priority for a pre-bankruptcy tort claimant over mortgage creditors. It was concerned with the most unusual situation where an estate *in custodia legis* was insufficient to meet its own expenses.

It is also significant that the court which decided the *RFC* case is the same court which had decided *Pitcairn* v. *Fisher*, 78 F. 2d 649 (8th Cir. 1935), and subsequently decided *Brooks* v. *St. Louis-San Francisco Ry.*, 180 F. 2d 185 (8th Cir. 1950), *cert. denied*, 339 U. S. 966 (1950). In

both of these cases, priority was denied to pre-bankruptcy tort claims on the ground that this treatment accorded with the general rule.

(b) *Bowen* v. *Hockley*, 71 F. 2d 781 (4th Cir. 1934), involved a federal equity receivership of a chemical corporation. Prior to the receivership, petitioner's husband had been killed as the result of injuries received as an employee of the company and petitioner had been receiving weekly workmen's compensation payments. Payments were discontinued when the company went into receivership. The Court of Appeals for the Fourth Circuit directed the receiver to continue payment of the weekly compensation installments falling due during the period of the receivership.

The case does not conflict with the decision below because no question of priority for tort claims was raised in *Bowen*. As the court stated in its opinion (at 782):

> "* * * the question presented to the court is, not whether a claim for compensation is entitled to preference * * * but whether receivers * * * should be required to continue making compensation payments awarded against the business as a self-insurer by a Workmen's Compensation Commission."

The limited significance of *Bowen* was pointed out by Judge Learned Hand in *In re New York, N. H. & H. R. R.*, 92 F. 2d 428 (2d Cir. 1937), *cert. denied*, 303 U. S. 650 (1938), a decision denying priority to tort claimants, as follows (at 430):

> "* * * In *Bowen* v. *Hockley* (C. C. A.), 71 F. (2d) 781, 94 A. L. R. 856, the Fourth Circuit did indeed establish an exception in the case of compensation awards to employees, though even then only to the extent of charging upon income such installments

> as fell due during the receivership. The reasoning on which this rested was that, as the employee's labor was necessary to the operation of the road, his compensation, like his wages, was for the benefit of the lienor. It may be doubted whether compensation stands like wages in the sense that doubts as to its priority in insolvency would even remotely affect the willingness of the men to continue to work; but with that we need not concern ourselves. * * *"

4. In a final effort to meet this Court's requirements for review, petitioners assert that the decision below "* * * is in conflict with the philosophy underlying the decisional law through which this Court has been diligent to protect the rights of FELA claimants since the enactment of the 1939 amendment" (Petition, p. 7). There is no assertion of any actual conflict with any decision of this Court. And, as we shall show, there is no basis for the assertion of a conflict with this Court's "philosophy" in FELA cases.

It should first be noted that there can be no contention here that the FELA claims, as such, have been discriminated against. The FELA claims have received the same classification as all other pre-receivership tort claims. Nor can there be any contention that the decision below attempted to insulate the employer from liability imposed under the FELA. All of the claims have either been allowed or are in the process of liquidation. The sole question here is how claims admittedly allowed are to be classified in a Chapter X proceeding.

Petitioners assume, however, that because FELA claimants are involved, any decision denying such claims a priority in a reorganization under Chapter X of the Bankruptcy Act must be in conflict with this Court's decisions in FELA cases. It is submitted that this is not so.

It may well be that the decisions of this Court in FELA cases arising after the 1939 amendment of the FELA have resulted in an expansion of the rights of railroad employees. But those decisions involved questions of procedure and liability under the FELA. They were not concerned in any way with the considerations to be evaluated in a clash of creditors in a bankruptcy situation.

The rights of railroad workers in FELA proceedings involve issues altogether different from their rights in a bankruptcy proceeding. This concept was clearly recognized by this Court in *Nathanson* v. *National Labor Relations Board*, 344 U. S. 25 (1952), which denied fifth class priority to back pay awards in a straight bankruptcy proceeding. The Court stated (at 28-29):

> "* * * The Board argues that the interest of the United States in eradicating unfair labor practices is so great that the back pay order should be given the additional sanction of priority in payment. Whether that should be done is a legislative decision. *The contest now is no longer between employees and management but between various classes of creditors.* The policy of the National Labor Relations Act is fully served by recognizing the claim for back pay as one to be paid from the estate. The question whether it should be paid in preference to other creditors is a question to be answered from the Bankruptcy Act. * * *" (Italics ours.)

As in *Nathanson*, the decision below relates to the contest "between various classes of creditors" and thus does not conflict in any sense with this Court's decisions relating to the contest "between employees and management" arising in FELA cases.

Conclusion

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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May 5, 1960